Harry's Take

May 16, 2023

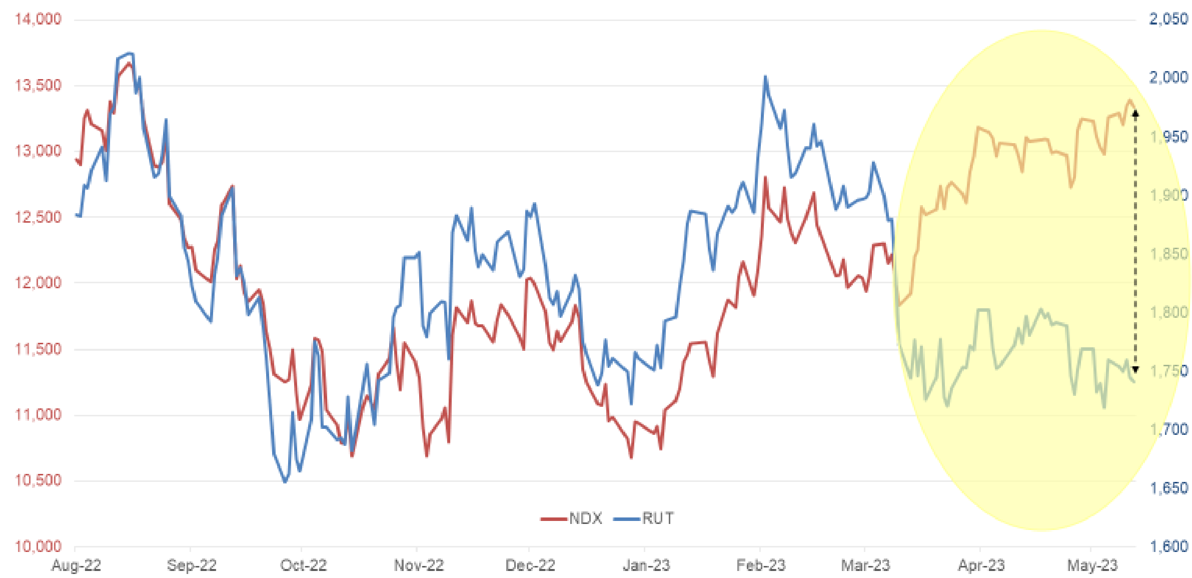
Two Glaring Divergences Say This Is a Bear Market Rally That Will End Soon!

At major turning points, a good market analyst always looks for divergences. I actually see this period as a more-important turning point than the Nasdaq top in November 2021 and the S&P 500 top on January 4, 2022. Why? Everyone expects that ultimately the markets will reach a new high, as they always have before, and that the Fed will pivot soon and get back to lowering rates.

First, the Fed is not likely to turn suddenly from raising rates and tightening to lowering rates. It makes sense to pause for at least a few months first. My view is that by the time the Fed does consider lowering rates again later this fall, it will be too late. The markets will be crashing to new lows and investors and consumers will lose confidence in the Fed's ability to fight the deeper recession that appears to be forming… If $10T in stimulus in two years was not enough, what would be?

I'll expand on this in the June issue of the *HS Dent Forecast*, but for now, here's two glaring divergences since early March that say (1) this is a bear market rally, not a new bull market, and (2) this rally will not last much longer, if it continues at all!

Big Divergence in Large Tech Stocks and Small Caps Since Early March



Source: Investing.com

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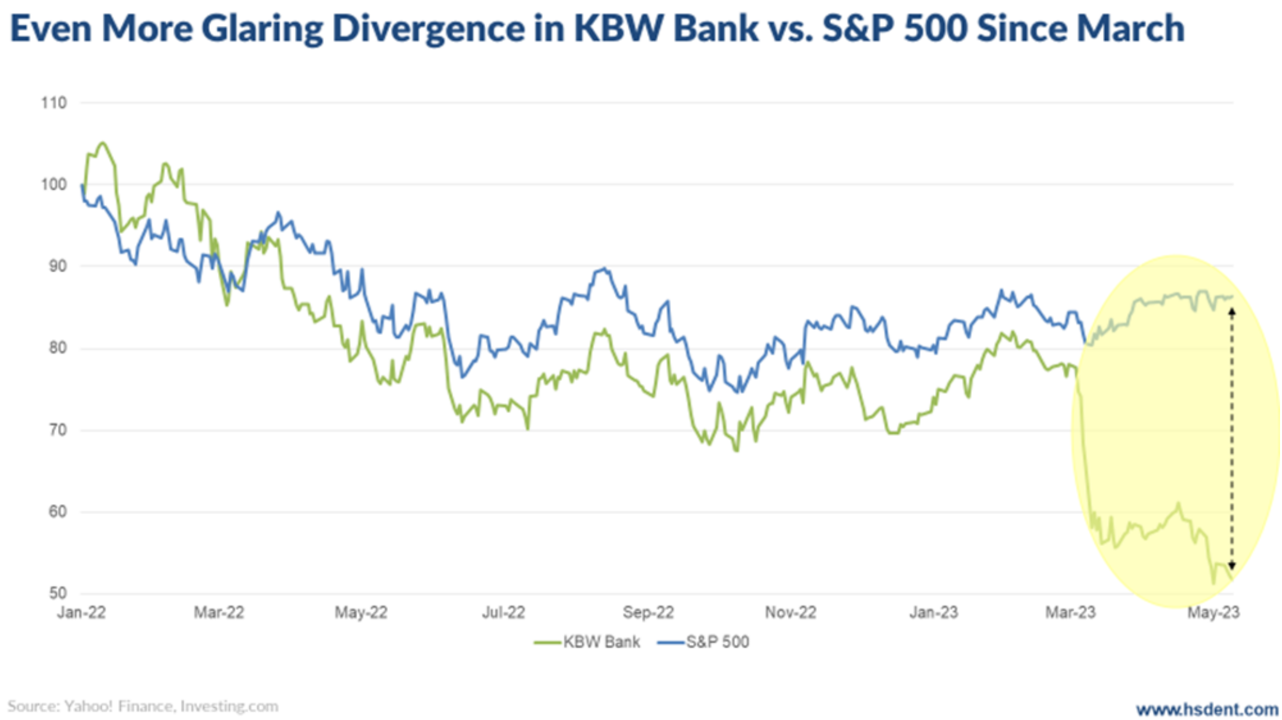
The first divergence you'd expect in a bear market is for large-cap stocks to outperform small caps, as the dumb money is less sophisticated and buys the known large caps, like Apple or Microsoft or Google. This chart shows that the small caps started falling harder in March, and in the recent rally since April, they have underperformed in the bounce even more.



And to me, the divergence shown in this second chart is even more ominous. The KBW Bank Index started falling like a rock at the beginning of March, while the S&P 500 has fallen only modestly. But the bank index has not really participated in the recent, modest bounce at all.

This bounce already has lasted seven months. Compare that with the first bounce of the 1929 crash, which lasted five months. Hence, the present bounce is already long in the tooth. These two divergences say that this market likely will turn down again within days…

And that's why you should consider this the more-important turn point. It will crack the assumptions that the markets will just go to new highs as usual and that the Fed can stop this "crash of a lifetime." When that happens, investors will get fearful for the first time since 2008, because they'll see that the markets can go down, despite the desperate efforts of the Fed to keep stimulating artificially.

All central banks do is react, and they tend to be too late, as with the recent tightening that started in March 2022. I think if the Fed lowers rates as I expect, likely in August or September, it will be too late!

Harry

Got a question or comment? You can contact us at info@hsdent.com.